

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendraye
Marshall Johnson
Ken Nickolai
Thomas Pugh
Phyllis A. Reha

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of a Petition by Interstate Power
and Light Company for Authority to Increase
Electric Rates in Minnesota

ISSUE DATE: March 3, 2006

DOCKET NO. E-001/GR-05-748

ORDER ACCEPTING SETTLEMENT,
ACCEPTING AND ADOPTING
ADMINISTRATIVE LAW JUDGE'S
REPORT WITH CLARIFICATIONS, AND
REQUIRING COMPLIANCE FILING

PROCEDURAL HISTORY

I. Initial Filings and Orders

On May 16, 2005, Interstate Power and Light Company (Interstate or the Company) filed a general rate case seeking an annual rate increase of \$4,768,696, or 7.1%. On July 8, 2005, the Commission issued three orders in this case, one finding the Company's filing substantially complete and suspending the proposed rates, one setting interim rates, and one referring the case to the Office of Administrative Hearings for contested case proceedings.

In its *Order Setting Interim Rates*, the Commission authorized the Company to collect an across-the-board interim rate increase of \$3,385,136 per year, or 5.0%, for service rendered on and after July 15, 2005. Interim rates are collected subject to refund under Minn. Stat. § 216B.16, subd. 3.

II. The Parties and Their Representatives

There were three active parties to the case: the Company, the Minnesota Department of Commerce (the Department), and the Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG).

The Company was represented by Jennifer Moore, Regulatory Attorney, Interstate Power and Light Company, 200 First Street Southeast, Post Office Box 351, Cedar Rapids, Iowa 52401-0351 and by Michael J. Bradley, Moss & Barnett, 4800 Wells Fargo Center, 90 South Seventh Street, Minneapolis, Minnesota 55402.

The Department was represented by Karen Finstad Hammel, Assistant Attorney General, 445 Minnesota Street, Suite 1400, St. Paul, Minnesota 55101-2131.

The RUD-OAG was represented by Ronald M. Giteck, Assistant Attorney General, 445 Minnesota Street, Suite 900, St. Paul, Minnesota 55101-2130.

III. Proceedings Before the Administrative Law Judge

The Office of Administrative Hearings assigned Administrative Law Judge Richard C. Luis to hear the case. Judge Luis held a pre-hearing conference, at which procedural and scheduling issues were resolved and two public hearings, at which Company and Department representatives were available for questioning, and ratepayers, other members of the public, and local government officials were invited to present their views.

The Company and the Department filed written testimony in the case. On November 4, 2005, the Company and the Department filed an Offer of Settlement (the Settlement) resolving all issues in the case between themselves.

The RUD-OAG opposed the Settlement's resolution of two issues – one permitting the Company to recover \$15,648 in start-up costs incurred in connection with TRANSLink, an abandoned transmission project, and one permitting the Company to increase the monthly residential customer charge from \$4.92 to \$8.35, reducing residential volumetric charges proportionally. The RUD-OAG requested an opportunity to cross-examine the Company's witnesses on these issues, and the Administrative Law Judge held an evidentiary hearing for that purpose.

All three parties filed initial and reply briefs on these two contested issues.

IV. Proceedings Before the Commission

On January 20, 2006, the Administrative Law Judge filed his Findings of Fact, Conclusions, and Recommended Order. With one exception, he found that the terms of the Settlement were supported by substantial evidence and in the public interest. The exception was the proposal to raise the residential customer charge from \$4.92 to \$8.35, which he found had not been demonstrated to be just and reasonable and unlikely to cause rate shock. He recommended adopting the Settlement's alternative residential customer charge of \$6.50, which he found had been demonstrated to be just and reasonable and not likely to cause rate shock.

On February 3, 2006, the Department filed exceptions to the Administrative Law Judge's Report. The Department did not challenge any of the Report's recommendations but did request clarifications/corrections to specific findings of fact within the Report.

On February 6, 2006, the RUD-OAG filed exceptions seeking disallowance of rate recovery of any costs incurred in connection with the TRANSLink project.

On February 7, 2006, the Company filed a letter stating that it did not except to the ALJ's Report but that it urged the Commission to consider both the Settlement's primary (\$8.35) and secondary (\$6.50) proposals as to the residential customer charge.

On February 23, 2006, the Commission heard oral argument, and the record closed under Minn. Stat. § 14.61, subd. 2. At oral argument all three parties reached agreement on all outstanding issues and recommended that the Commission (1) accept the Settlement's treatment of TRANSLink costs, with the express understanding that settlement terms, including those pertaining to these costs, do not constitute Commission precedent; and (2) accept the Administrative Law Judge's recommendation to set the residential customer charge at \$6.50.

FINDINGS AND CONCLUSIONS

I. The Legal Standard

Under the Public Utilities Act, utilities seeking a rate increase have the burden of proof to show that the proposed rate change is just and reasonable. Minn. Stat. § 216B.16, subd. 4. Any doubt as to reasonableness is to be resolved in favor of the consumer. Minn. Stat. § 216B.03.

The Act also encourages settlements. Before beginning contested case proceedings on a general rate case, Administrative Law Judges are required to convene a settlement conference for the purpose of encouraging settlement of some or all of the issues in the case. They are authorized to reconvene the settlement conference at any point before the case is returned to the Commission, at their own discretion or at the request of any party. Minn. Stat. § 216B.16, subd. 1a (a).

The Commission is authorized to accept, reject, or modify any settlement. It can accept a settlement only upon finding that to do so is in the public interest and is supported by substantial evidence. Minn. Stat. § 216B.16, subd. 1a (b).

While the Commission recognizes that compromise is a key ingredient of any settlement, it also recognizes that resolving disputed issues in rate cases is fundamentally different from resolving disputes between private litigants:

In deciding whether to accept the Offer of Settlement, the Commission must apply a different standard than is normally used by the courts. Unlike the traditional function of civil courts, the Commission's primary function is not to resolve disputes between litigants. Instead, it is an affirmative duty to protect the public interest by ensuring just and reasonable rates.

In the Matter of a Petition by the U.S. Department of Defense, the General Services

Administration, and All Other Federal Executive Agencies of the United States
Challenging the Reasonableness of the Rates Charged by Northwestern Bell
Telephone Company, Docket No. P-421/CI-86-354, ORDER ACCEPTING
OFFER OF SETTLEMENT (February 10, 1988) at 3.

Because rate case decisions can have far-reaching consequences for persons who were not at the negotiating table, the Commission has long required settling parties to document that all issues have been settled within the zone of regulatory reasonableness:

In non-ratemaking settlement negotiations it is common for parties to concede some issues to obtain a more favorable resolution of others they value more highly. This is reasonable and appropriate in private disputes, where the goal of the settlement process is to reach a result satisfactory to all parties. In Commission proceedings, however, the goal of the process is to serve the public interest.

This requires protecting the interests of the Company, the public, and all customer classes, whether or not their interests are vigorously represented. It requires resolving every issue within the bounds of acceptable regulatory practice, since future rate structures are built on the foundations established in past rate cases. For these reasons the Commission scrutinizes settlements with care and requires documentation of the reasonableness of the disposition of all issues.

In the Matter of the Application of Interstate Power Company for Authority to
Change its Rates for Natural Gas Service in the State of Minnesota, Docket No.
G-001/GR-90-700, ORDER ACCEPTING AND ADOPTING STIPULATION AND
OFFER OF SETTLEMENT (June 27, 1991), at 6-7.

II. The Settlement

Overall, the Settlement reduced the proposed increase in the Company's annual revenue requirement from \$4,768,696, or 7.1%, to \$1,245,651, or 1.86%. This overall reduction came from numerous discrete adjustments over the course of negotiations, only two of which sparked controversy and require discussion.

A. TRANSLink Costs

The most controversial of the negotiated adjustments was the settling parties' agreement to permit the Company to include in test year expense \$15,648 in start-up expenses incurred in connection with the Company's participation in TRANSLink, an ambitious and now abandoned project to pool the transmission assets of 13 public, cooperative, and investor-owned utilities to form a single, independent, transmission company. The project was controversial from start to finish, raising complex jurisdictional issues that implicated state commissions' ability to regulate individual utilities' transmission investment and cost recovery.

The amount for which the Settlement permitted recovery was one-half of the Minnesota jurisdictional allocation of the Company's TRANSLink expenses, amortized over five years. This

amount had virtually no rate impact; its inclusion was initially opposed by RUD-OAG, however, for reasons of principle and precedent.

B. Residential Customer Charge

The settling parties also reached agreement on rate design issues, the most controversial of which was the recommendation to raise the monthly residential customer charge from \$4.92 to \$8.35. The residential customer charge is a fixed monthly charge assessed without regard to usage levels. It is designed to recover fixed costs that do not vary with usage, such as constructing and maintaining infrastructure, reading meters, and conducting billing and collection services.

The Commission has long been cautious about using customer charges – as opposed to usage charges – to recover utilities’ revenue requirements, citing the potential for adverse impacts on low-income households, the statutory directive to set rates to encourage conservation and renewable energy use,¹ and the strong public interest in maintaining clear and credible residential utility rates.

Conscious of the Commission’s longstanding disapproval of high residential customer charges, the settling parties not only reached a primary agreement to raise the charge to \$8.35, but reached an alternative agreement to raise the charge to \$6.50. The RUD-OAG opposed the primary agreement and supported the secondary one.

As stated above, at oral argument all three parties reached agreement on the contested issues, agreeing to permit recovery of the TRANSLink expenses on a non-precedential basis and to raise the residential customer charge to the \$6.50 level of the Settlement’s alternative recommendation.

III. Summary of Commission Action

The Commission will accept the Settlement, adopting its alternative proposal on the residential customer charge, as recommended by the Administrative Law Judge. The Commission will accept and adopt his report, findings, and recommendations, with minor clarifications, and will set forth the financial schedules memorializing those decisions.

The Commission will require a compliance filing implementing the decisions made herein, will require an interim rates refund plan, and will establish a comment period for these filings.

These matters will be taken up in turn.

IV. Settlement Accepted

¹ Minn. Stat. 216B.03.

The Commission finds that the Settlement submitted by the parties, including the alternative recommendation on the residential customer charge, is supported by substantial evidence, is in the public interest, and should be approved.

The Settlement cites to record evidence to support and explain its disposition of every issue, and the evidentiary hearing conducted on the two issues initially contested by the RUD-OAG clarified and expanded the record at several key points. The Commission concurs with the parties that all issues have been settled within the zone of regulatory reasonableness, in a manner supported by substantial evidence, and on terms consistent with the public interest.

This is true of all issues, including the late-settled issues of the TRANSLink start-up costs and the residential customer charge.

On the TRANSLink issue, the Commission finds that TRANSLink start-up costs could reasonably be viewed as prudently incurred for the benefit of ratepayers and that the decision to permit recovery of 50% of the Minnesota jurisdictional portion of these costs falls within the zone of regulatory reasonableness. Since recovery is being permitted under the terms of a comprehensive settlement, it does not constitute action on the merits of any claim of right to recovery, nor does it create any binding precedent for future consideration of the issue.

On the residential customer charge issue, the Commission accepts and adopts the Administrative Law Judge's recommendation, as recommended by all parties.

V. Administrative Law Judge's Report Clarified

A. Forecasting Methodology

The Department asked the Commission to clarify that the statistical method the parties agreed to use to estimate the parameters in the weather-normalization model used in forecasting sales volumes was the Generalized Least Squares regression model developed by Department witness Hwikwon Ham.

No one contested this clarification, and the Commission so clarifies.

B. Rate Case Expenses

The Department asked the Commission to clarify that the Settlement provision permitting recovery of \$510,699 in current rate case expenses (amortized over four years, for a test year amount of \$127,675) was not inconsistent with the Company's last rate case order, as suggested by the Administrative Law Judge's Report.

The Company's last rate case order imposed a cap of \$250,000 on recoverable rate case expenses

in its next rate case.² The Settlement in this case permits rate recovery of \$510,699 in rate-case-related expenses, which the Administrative Law Judge thought fell outside the terms of the earlier order.

The Department pointed out that the cap applied only to the Company's *own* rate case expenses – which did not exceed \$250,000 – and did not apply to regulatory assessments for work performed by regulatory bodies, which was what brought to total of recoverable expenses to \$510,699.

No one contested this clarification, and the Commission so clarifies.

C. Incentive Compensation

The Department asked the Commission to clarify that it had initially opposed rate recovery of *all* incentive compensation payments, conceding only that *if* incentive compensation were treated as recoverable, it should be capped at 15% of individuals' base salaries.

No one contested this clarification, and the Commission so clarifies.

D. Nuclear Plant Divestiture

The Department asked the Commission to clarify that any rate changes in this or future rate proceedings must comply with the ratemaking protections adopted by the Commission in its order permitting the Company to sell its nuclear plant, the Duane Arnold Energy Center, to a company specializing in operating nuclear power plants.³

No one contested this clarification, and the Commission so clarifies.

E. LIHEAP Data and the Usage Patterns of Low-Income Households

The Department asked the Commission to delete the Administrative Law Judge's Finding # 30, which reads as follows:

² *In the Matter of a Petition by Interstate Power and Light Company for Authority to Increase Electric Rates in Minnesota*, E-001/GR-03-767, Findings of Fact, Conclusions of Law, and Order; Order Modifying Settlement (April 5, 2004).

³ *In the Matter of the Joint Application for Approval and Consent of Interstate Power and Light Company and FPL Energy Duane Arnold, LLC, to Sell and Transfer Ownership in the Duane Arnold Enemy Center to FPL Energy Duane Arnold, LLC*, Docket No. E-001/PA-05-1272, ORDER APPROVING SALE AND TRANSFER OF OWNERSHIP INTEREST IN THE DUANE ARNOLD ENERGY CENTER WITH CONDITIONS (January 25, 2006).

The Department did not affirmatively demonstrate that intraclass subsidies were appropriately addressed using the LIHEAP [Low Income Heating Assistance Program] data. Such a demonstration would compare actual costs incurred by differently situated customers under the proposed rates. No such analysis was offered in this matter. (Footnote omitted.)

The Department disagreed with the substance of this finding. It was also concerned that the finding could be read to suggest that the Department bore the burden of proof on this and similar rate design issues. And it was concerned that the finding could be read as a more definitive rejection of the LIHEAP data than the Administrative Law Judge had intended or than was appropriate.

The parties were unclear on the precise meaning of the finding and on its precedential value if adopted by the Commission. To remove ambiguity and avoid making this finding – as opposed to the issue it addresses – the subject of future controversy, the Commission will revise the finding as set forth below:

It was not affirmatively demonstrated that intraclass subsidies were appropriately addressed using LIHEAP data exclusively.

VI. Financial Schedules

Gross Revenue Deficiency

Acceptance of the settlement results in a Minnesota jurisdictional gross revenue deficiency of \$1,247,651 for the test year, as shown below:

REVENUE REQUIREMENTS SUMMARY

Average Rate Base	\$135,756,300
Rate of Return	8.575%
Required Operating Income	\$ 11,641,103
Operating Income	\$ 10,909,605
Income Deficiency	\$ 731,498
Gross Revenue Conversion Factor	1.705611
Gross Revenue Deficiency	\$ 1,247,651

Rate Base Summary

In accepting the settlement, the Commission adopts the rate base of \$135,756,300 as agreed upon in the settlement.

RATE BASE SUMMARY

Test Year Ending December 31, 2004

PLANT IN SERVICE	
Production	\$126,969,064
Intangible	1,901,513
Transmission	36,778,663
Distribution	90,857,723
General and Common	25,734,282
Total Plant in Service	<u>\$282,241,245</u>
RESERVE FOR DEPRECIATION	
Production	\$ 65,623,415
Intangible	1,646,822
Transmission	15,694,132
Distribution	44,504,340
General and Common	11,997,145
Total Reserve for Depreciation	<u>\$139,465,854</u>
NET PLANT IN SERVICE	\$142,775,391
OTHER RATE BASE ITEMS	
Construction Work in Progress	\$ 5,157,964
Accumulated Deferred Income Taxes	(14,131,451)
Cash Working Capital	(1,282,562)
Materials & Supplies	1,719,989
Fuel Inventories	1,474,835
Prepayments	192,349
Customer Deposits	(138,525)
Customer Advances	(11,690)
Total Other Rate Base Items	<u>\$ (7,019,091)</u>
TOTAL AVERAGE RATE BASE	<u><u>\$135,756,300</u></u>

Operating Income Summary

In accepting the settlement, the Commission adopts the test-year Minnesota jurisdictional operating income of \$10,909,605 agreed upon in the settlement as appropriate for the test year.

OPERATING INCOME SUMMARY
Test Year Ending December 31, 2004

UTILITY OPERATING REVENUES

Sales of Electricity	\$ 65,693,208
Other Operating Revenue	1,607,444
Total Operating Revenue	\$ 67,300,652

UTILITY OPERATING EXPENSES

Fuel for Production	\$ 9,801,947
Purchased Power	6,454,418
Other Production	7,314,191
Transmission	1,474,258
Distribution	2,911,515
Customer Accounts	1,441,245
Customer Service and Sales	3,490,537
Administrative and General	5,892,815
Operating Expenses	\$ 38,780,926

Depreciation	\$ 10,047,579
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Taxes:

Taxes Other Than Income	\$ 3,331,213
Federal Income Tax	3,473,273
State Income Tax	1,095,770
Total Taxes	\$ 7,900,256

AFUDC	<u>\$ 337,714</u>
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UTILITY OPERATING INCOME	<u><u>\$ 10,909,605</u></u>
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Cost of Capital Summary

In accepting the settlement, the Commission adopts a 10.39-percent return on equity, with a corresponding overall rate of return of 8.575-percent, as set forth below.

Component	% of Capitalization	Cost	Weighted Cost
Short Term Debt	1.523%	2.240%	0.034%
Long Term Debt	41.634%	6.696%	2.788%
Preferred Stock	7.745%	8.411%	0.651%
Common Equity	49.099%	10.39%	5.101%
Total	100.00%		8.575%

VII. Compliance Filing Required

The Commission will require the Company to make a compliance filing within 30 days of the date of this order showing the final rate effects of the decisions made here and proposing a plan for refunding the difference between the amounts it collected in interim rates and the amounts it is authorized to collect in final rates. The Commission will establish a brief comment period to give interested persons a chance to review and comment on that filing.

The Commission will so order.

ORDER

1. Interstate Power and Light Company is authorized to increase its gross annual Minnesota jurisdictional revenues by \$1,247,651 in order to produce total gross annual jurisdictional operating revenues of \$68,548,303.
2. The Commission accepts the Offer of Settlement and adopts its alternative position on the residential customer charge, increasing that charge to \$6.50.
3. The Commission accepts and adopts the Findings of Fact, Conclusions, and Recommended Order of the Administrative Law Judge, with the clarifications set forth above, and with Finding 30 reworded to read as follows:

It was not affirmatively demonstrated that intraclass subsidies were appropriately addressed using LIHEAP data exclusively.

4. The Commission approves the proposed \$0.00269 per kWh Conservation Cost Recovery Charge included in base rates and authorizes the continuation of the Conservation Cost Recovery Adjustment of \$0.00097 per kWh until reviewed in an upcoming Conservation Cost Recovery Adjustment filing.
5. The Company shall honor its agreement in the Settlement to include costs related to Midwest Independent System Operator (MISO) schedules 1, 2, 9, 11, and 18 in future filings involving analyses of the impact of its MISO membership.
6. In its next rate case filing, the Company shall follow the class-cost-of-service-study procedures offered on pages 20-21 of the Settlement.
7. Within 30 days of the date of this Order, the Company shall file with the Commission, for its review and approval, and shall serve on all parties to this proceeding, a compliance filing implementing the decisions made herein and containing at least the following items:
 - A. Revised schedules of rates and charges reflecting the revenue requirement and the

rate design decisions herein, along with the proposed effective date, and including the following information:

1. A breakdown of Total Operating Revenues by type.
2. Schedules showing all billing determinants for the retail sales (and sale for resale) of electricity. These schedules shall include but not be limited to:
 - (a) Total revenue by customer class.
 - (b) Total number of customers, the customer charge and total customer charge revenue by customer class.
 - (c) For each customer class, the total number of energy and demand related billing units, the per unit energy and demand related cost of energy, and the total energy and demand related sales revenues.
- B. Proposed customer notices explaining the final rates, including the increases in the customer charge.
- C. A revised base cost of energy to be put into effect with final rates, supporting schedules, and revised fuel clause tariffs.
- D. A schedule detailing the Conservation Improvement Program (CIP) tracker balance at the beginning of interim rates, the revenues (Conservation Cost Recovery Charge and CIP Adjustment Factor) and costs recorded during the period of interim rates, and the CIP tracker balance at the time final rates become effective.
- E. A proposal to make refunds of interim rates, pursuant to Minn. Stat. § 216B.16, subd. 1(b), including interest calculated at the average prime rate, to affected customers.
8. Comments on the filing required under paragraph 7 shall be filed within 15 days of the date of the filing.
9. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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